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# In the Supreme Court of the United States

OCTOBER TERM, 1964

No. —

FEDERAL TRADE COMMISSION, PETITIONER

v.

BROWN SHOE COMPANY, INC.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of the Federal Trade Commission, petitions for a writ of certiorari to review the judgment of the Court of Appeals for the Eighth Circuit entered in this case on December 8, 1964.

### OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, pp. 1a-22a) is reported at 339 F. 2d 45. The opinion of the Federal Trade Commission (R. 53-89)<sup>1</sup> is not yet reported.

### JURISDICTION

The judgment of the court of appeals was entered on December 8, 1964 (App. B, *infra*, p. 23a). On March 8, 1965, Mr. Justice White extended the time for filing a petition for a writ of certiorari to and

<sup>1</sup> "R. —" refers to the printed three-volume record in the court of appeals.

including May 7, 1965. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

#### QUESTION PRESENTED

Pursuant to the "Franchise Stores Program" of the Brown Shoe Company, more than 700 independent retail shoe stores agreed, in return for specified benefits, to carry no line of shoes conflicting with Brown Shoe brands. The Federal Trade Commission held the "Franchise Stores Program" to be an unfair method of competition under Section 5 of the Federal Trade Commission Act, finding that the plan "effectively foreclosed \* \* \* [Brown's] competitors from selling to a significant number of retail shoe stores." The court of appeals, however, held (App. A, *infra*, p. 14a) that the Brown plan did not violate Section 5 because it involved sales methods which "have never heretofore been \* \* \* regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly' " (*Federal Trade Commission v. Gratz*, 253 U.S. 421, 427) and because the Commission had not shown the plan to be either a tying arrangement or an exclusive dealing arrangement in violation of the Clayton or Sherman Acts. The question presented is whether the court of appeals thus applied an unduly narrow construction of the Commission's powers under Section 5 of the Federal Trade Commission Act.

#### STATUTE INVOLVED

Section 5(a) of the Federal Trade Commission Act, 38 Stat. 717, 719, as amended, 15 U.S.C. 45(a), provides in part:

Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are declared unlawful.

The Commission is empowered and directed to prevent persons, partnerships, or corporations \* \* \* from using unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce.

#### STATEMENT

The court below set aside an order of the Federal Trade Commission prohibiting the Brown Shoe Company, Inc. ("Brown Shoe") from entering into or maintaining certain types of franchise agreements with independent shoe retailers.<sup>1a</sup> The proceeding before the Commission was instituted by a complaint (R. 3-9) filed by it on October 13, 1959, charging Brown Shoe with unfair methods of competition in violation of Section 5 of the Federal Trade Commission Act. Following extensive administrative proceedings, the Commission, on February 20, 1963, issued its opinion and final order. On the basis of the evidence adduced at the hearing (most of which, insofar as it is relevant here, is undisputed) the Commission found the following facts:

In 1959, Brown Shoe was the country's second largest manufacturer of shoes in terms of dollar volume (R. 76) and the third largest in terms of pairs

<sup>1a</sup> The court also reversed a Commission finding that Brown Shoe attempted to fix and maintain the retail prices at which its franchisees would sell Brown products (App. A, *infra*, pp. 21a-22a). Since that determination depended upon the substantiality of evidence to establish particular facts, review of it is not sought in this petition.

of shoes produced (*ibid.*). In addition to marketing its shoes through mail order houses and a substantial number of company-owned retail stores, Brown distributes shoes through several thousand independent retail shoe stores. More than 700 of these stores have agreed to join the "Brown Franchise Stores Program" (R. 3-4; 67; 22E-45E). Under this program, Brown offers a "package" of benefits and services, including "architectural plans, service of a field representative, merchandising records, retail sales training program, accounting system, national and regional meetings, and group purchasing of insurance, rubber footwear, and display material" (R. 65, note 17) in return for a promise (either written or oral) that the retailer will "[c]oncentrate my business within the grades and price lines of shoes representing Brown Shoe Company Franchises of the Brown Division *and will have no lines conflicting with Brown Division Brands of the Brown Shoe Company*" (emphasis added) (R. 56).<sup>2</sup> Brown Shoe sometimes permits its franchisees to remain in the plan (and thus receive its benefits) while carrying short or specialty lines which partially "conflict" with its own brands. In general, however, it is successful in excluding competitive lines from the stock of its franchisees (R. 68). On the average, franchised stores purchase 75 percent of their total shoe requirements from Brown, with most of the remainder consisting of either higher or lower price

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<sup>2</sup> The franchise agreement is terminable by either party upon 30 days' notice. However, the Commission found that in actual operation "the relationship between Brown and its franchisees is a reasonably stable one" (R. 68).

shoes than those available from Brown Shoe—shoes which do not constitute “conflicting” lines within the meaning of the agreement (*ibid.*).

The Brown franchise agreements are policed and enforced by a team of field men whose reports bore for a period of time the printed legend: “Encourage concentration on B.S.C. lines and elimination of conflicting lines” (R. 59). If particular retailers refuse to drop conflicting lines despite warnings, they are dropped from the franchise plan (R. 60). Non-franchise dealers can purchase shoes from Brown, but they do not receive most of the benefits offered under the plan to dealers who concentrate on Brown shoes (R. 60–61). During the years 1949 through 1955, Brown Shoe dropped 22 stores from the franchise program for “persist[ing] in carrying conflicting lines” (R. 60, 29) and from November, 1954, to April, 1958, more than a dozen dealers were similarly dropped (*ibid.*).

At the time of the hearing, a total of 766 independent shoe retailers were participating in the program (R. 67, 73). This was a “select group” all of whom were considered “the better credit risks” (R. 76–77). Between 1959 and 1961, the number of stores enrolled in the program increased 12 percent, even though the prospective number of good retail outlets was generally diminishing (R. 77).<sup>2</sup> In addition to these 766 franchised retailers, Brown Shoe sold to approxi-

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<sup>2</sup> The Commission found that this was part of a general trend to vertical integration in the shoe industry either by way of merger or contractual arrangements (R. 77).

mately 208 so-called "Wohl Plan" accounts, who were independent retailers partially financed by Brown Shoe and generally buying their requirements from a Brown subsidiary, the Wohl Shoe Company (R. 77). Another Brown Shoe subsidiary, the Regal Shoe Company, owned a chain of 92 retail outlets (R. 77). There was a total of 70,000 shoe dealers classified as "retail shoe outlets" at the time of the hearing (R. 73).

At the hearing, the Commission adduced evidence of the effect of the Brown franchise plan upon Brown's competitors—particularly upon small manufacturers. Thus, the Leverenz Shoe Company (a firm not among the top 70 (R. 179-E)), which in 1955 sold one account \$2,399.12 worth of shoes, lost the account altogether in 1956 when the dealer became a Brown Shoe franchisee (R. 70). Similarly, the Weyenberg Shoe Co. (the 46th largest manufacturer in the country in terms of pairage output (R. 179-E)) saw sales to two of its accounts drop from \$8,388 to \$186.00 and from \$2,782 to zero, respectively, when the dealers joined the Brown Shoe franchise program and agreed to drop conflicting lines (R. 70). And the Juvenile Shoe Corporation (ranked 60th in pairage output as contrasted with Brown Shoe's number 3 position (R. 179-E)), which had formerly sold as many as 1,530 pairs of shoes annually to a shoe store in Plymouth, Michigan, suffered a decline to only 188 pairs following the store's enrollment in the Brown Shoe franchise program (R. 70).

The Commission affirmed the examiner's finding that, as a result of Brown Shoe's franchise plan, its

"competitors are foreclosed from selling to the market represented by the franchise dealers" (R. 68). The Commission concluded that "[Brown's] operation of the franchise plan \* \* \* constitutes an unfair trade practice under Section 5 of the Federal Trade Commission Act" because it foreclosed Brown's competitors from selling to a "significant number of retail stores \* \* \*" (R. 73). In the Commission's view, "[t]he practice of conditioning the benefits of membership in the plan to adherence to the restrictive terms of the franchise agreement for the purpose of foreclosing other manufacturers from selling to its franchisees is akin to the operation of tying clauses generally held as inherently anticompetitive" (R. 73).

In reaching this conclusion, the Commission rejected (R. 74) Brown Shoe's argument that in a proceeding under Section 5 of the Federal Trade Commission Act challenging a trade practice primarily on the ground that it unduly foreclosed competition, the tests applicable to Sections 3 and 7 of the Clayton Act (whether the effect of a practice may be substantially to lessen competition or to tend to create a monopoly) must be applied. The Commission noted (R. 74) that "the former Act was designed \* \* \* to stop in their incipency acts and practices which, when full blown, would violate [the Clayton Act] \* \* \*" (footnote omitted). In any event, the Commission concluded (R. 75) after a full canvass of the market facts including the structure of the shoe industry, and in the light of this Court's decision in *Brown Shoe Co. v. United States*, 370 U.S. 294, "that the prospective competitive impact of the franchise

program is such that the standards of illegality under Section 3 and Section 7 of the Clayton Act, as amended, have been met." In summary, the Commission found (R. 79) that "[t]o foster the competitive position of the smaller manufacturers, Brown should be prohibited from entering into arrangements with its customers interfering with the latter's independent judgment in making purchasing decisions." Commissioner Elman concurred in this decision on the basis that the "exclusive vertical arrangements shown by this record have the requisite competitive effects \* \* \*" (R. 88-89).

The court of appeals reversed and directed dismissal of the complaint (App. A, *infra*, pp. 1a-22a). The court did not reject the Commission's findings as to the anticompetitive effect of the Brown Shoe franchise plan. Rather, relying on *Federal Trade Commission v. Gratz*, 253 U.S. 421, 427, the court ruled (App. A, *infra*, p. 13a) that the Brown Shoe franchise program "could [not] possibly be classified as an 'unfair method of competition' " since Brown, as well as International Shoe Company (the nation's leading manufacturer of shoes (R. 180-E)) and the General Shoe Company (the nation's third leading shoe producer (*ibid.*)), had operated similar programs for a number of years and "[n]o court has gone so far as to hold like programs or methods of doing business unlawful under Section 5 of the Federal Trade Commission Act and such programs or sales methods have never heretofore been \* \* \* regarded as opposed to good morals because characterized by deception, bad faith, fraud, or oppression, or as against public policy be-

cause of their dangerous tendency unduly to hinder competition or create monopoly' ” (App. A, *infra*, p. 14a). The court went on to hold in some detail that Brown Shoe's franchise program did not constitute either an illegal tying arrangement under the Sherman Act or an exclusive dealing arrangement illegal under Section 3 of the Clayton Act. Finally, the court found this Court's decision in *Brown Shoe Co. v. United States*, *supra*, wholly irrelevant. In sum, the court concluded that “[b]y passage of the Federal Trade Commission Act, particularly § 5 thereof, we do not believe that Congress meant to prohibit or limit sales programs such as Brown Shoe engaged in in this case” (App. A, *infra*, p. 21a).

#### REASONS FOR GRANTING THE WRIT

The court of appeals has significantly and improperly restricted the power of the Federal Trade Commission under Section 5 of the Federal Trade Commission Act to deal with anticompetitive practices. Without considering the effect upon competition of the substantial market foreclosure which the Brown Shoe franchise plan caused, the court ruled that the Commission could not condemn the plan as an unfair method of competition under Section 5 because (1) under *Federal Trade Commission v. Gratz*, 253 U.S. 421, 427, such purchase plans “have never heretofore been ‘regarded as opposed to good morals because characterized by deception, bad faith, fraud or oppression, or as against public policy because of their dangerous tendency unduly to hinder competition or create monopoly’ \* \* \* ” (App. A, *infra*, p. 14a);

and, because (2) in the court's view, they did not constitute tying or exclusive dealing arrangements that violated the Sherman or Clayton Acts. This holding wholly ignores the flexible nature of Section 5 and the Commission's power to give content to that section in light of particular anticompetitive practices disclosed through case-by-case adjudication, without being bound by traditional concepts of commercial morality or the relatively specific criteria of the Sherman and Clayton Acts.

The court of appeals decision will, unless reversed, seriously impede the power of the Commission to preserve competition through Section 5. There are presently pending before the Commission at least twelve investigations involving the practice of powerful suppliers, like Brown Shoe, of furnishing services and other benefits to customers in exchange for a promise to handle the supplier's products on a preferential or exclusive basis. These practices may, as in the present case, have a marked tendency to foreclose small suppliers from access to the market, thus seriously threatening competition. Under the holding of the court of appeals, however, since these practices have never, in the court's view, been "regarded as opposed to good morals \* \* \* or as against public policy because of their dangerous [anticompetitive] tendency," the Commission could not act under Section 5 unless it found a violation of either the Sherman or Clayton Acts. This Court should decide whether the strict limits thus imposed by the court of appeals upon the Commission's use of Section 5 are proper.

In addition, the case warrants review in order to effectuate this Court's decision in *Brown Shoe Co. v. United States*, 370 U.S. 294. Brown Shoe's effort there to preempt a substantial portion (yet smaller than that involved here) of the retail shoe market by acquisition was held to violate Section 7 of the Clayton Act. Under the ruling below, however, Brown (and other firms in other industries having similar programs of distribution) may accomplish similar results through the use of "franchise" programs and other devices which establish patterns of exclusive dealing.

1. The decision below is grounded upon an erroneous interpretation of the meaning and scope of Section 5 of the Federal Trade Commission Act. The court's reliance upon *Federal Trade Commission v. Gratz*, *supra*, completely ignores this Court's post-*Gratz* decisions which state that the Federal Trade Commission Act, and particularly Section 5, was enacted for the purpose of vesting the Commission with "adequate powers to hit at every trade practice \* \* \* which restrained competition or might lead to such restraint if not stopped in its incipient stages" (*Federal Trade Commission v. Cement Institute*, 333 U.S. 683, 693; emphasis added). As the Court stated in *Federal Trade Commission v. Motion Picture Adv. Serv. Co.*, 344 U.S. 392, 394-395:

Congress advisedly left the concept ["unfair methods of competition"] flexible to be defined with particularity by the myriad of cases from the field of business. \* \* \* It is also clear that the Federal Trade Commission Act was designed to supplement and bolster the Sherman Act and the Clayton Act \* \* \*—to stop in their incipency acts and practices which, when